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BEFORE THE ARIZONA CORPORATION COMMISSION

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JEFF HATCH-MILLER
Chairman
MARC SPITZER
Commissioner
WILLIAM MUNDELL
Commissioner
MIKE GLEASON
Commissioner
KRISTIN MAYES
Commissioner

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AZ CORP COMMISSION
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**IN THE MATTER OF QWEST
CORPORATION'S FILING OF
RENEWED PRICE REGULATION PLAN.**

DOCKET NO. T-01051B-03-0454

**IN THE MATTER OF THE
INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.**

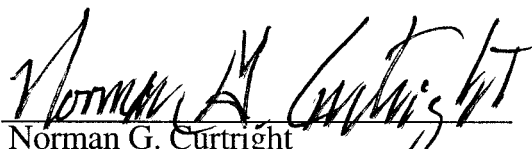
DOCKET NO. T-00000D-00-0672

**NOTICE OF FILING DIRECT
TESTIMONY IN SUPPORT OF
SETTLEMENT.**

Qwest Corporation files herewith the public/redacted version of the Direct Testimony in Support of Settlement, with associated exhibits, of David L. Ziegler, Jerrold L. Thompson and Philip E. Grate.

SUBMITTED this 6th day of September 2005.

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2 **were filed this 6th day of September, 2005 with:**

3 Docket Control
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7 **COPY of the foregoing mailed/mailed**
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Diane Kypow

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN)	DOCKET NO. T-01051B-03-0454
)	
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS)	DOCKET NO. T-00000D-00-0672
)	
)	

DAVID L. ZIEGLER

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

TESTIMONY INDEX

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EXECUTIVE SUMMARY

My testimony describes the consumer benefits of the Settlement Agreement (the "Agreement"); the term of the Agreement; notice to consumers; filing of tariffs and price lists; elimination of certain reporting requirements; and why the Agreement is in the public interest.

The Agreement has quantifiable consumer benefits that total \$5.5M and additional benefits that cannot be quantified in monetary terms because the benefit is either non-monetary or the number of impacted customers is unknown. Quantifiable benefits include the reduction in zone charges, a reduction in residential non-published and residential non-listed telephone listings and increased funding for the Telephone Assistance Plan for the Medically Needy. Consumer benefits that are not quantified in monetary terms are changes to the service quality tariff, increased line extension credits, a rate cap on directory assistance and the hard cap on Basket 1 services.

The proposed Agreement is in the public interest because it provides numerous consumer benefits as described in my testimony while allowing Qwest to be regulated similarly to its competitors in an increasingly competitive Arizona market.

It is my recommendation that the Commission find that the Agreement is in the public interest and approve the Agreement as filed.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND CURRENT POSITION.

A. My name is David Ziegler. I am employed by Qwest Services Corporation as Assistant Vice President – Arizona Public Policy. My business address is 4041 North Central Avenue, Phoenix, Arizona 85012. I am providing this testimony on behalf of Qwest Corporation (“Qwest”), the public service corporation providing telecommunications service in Arizona.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. I am responsible for regulatory, legislative and community affairs in Arizona.

Q. PLEASE REVIEW YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. I received a Bachelor of Science degree in Business Administration from Columbia College in 1988. I have also attended numerous industry seminars on economics, management, marketing and technical courses. I began my career with Qwest (Mountain Bell) in 1978 in the business office. In 1980, I accepted the position of Manager - Residence Operations, where I was responsible for developing methods and procedures for billing and collections. In 1986, I moved to Strategy Development, where I was responsible for cost of service studies and economic regulatory issues. In 1994, I accepted the position of Manager-Regulatory Affairs in Colorado Regulatory where I was responsible for

1 managing regulatory issues before the Colorado Public Utilities Commission. In
2 1997, I accepted the position of Director - Regulatory Affairs in Colorado
3 Regulatory. In 2001, I accepted the position of Regional Director – Out of
4 Region, where I was responsible for regulatory and legislative activities in a
5 14-state area. In 2002, I accepted my current position.

6 **Q. HAVE YOU PREVIOUSLY APPEARED BEFORE THE ARIZONA**
7 **CORPORATION COMMISSION OR OTHER PUBLIC UTILITY COMMISSIONS**
8 **AS A WITNESS IN REGULATORY PROCEEDINGS?**

9 A. I have testified before the Arizona Corporation Commission (the “Commission”) in the hearing on the proposed settlement in Docket No. RT-00000F-02-271,
10 Docket No. T-00000A-97-0238, and Docket No. T-00151B-02-0871
11 (consolidated). I have also testified before the Colorado Public Utilities
12 Commission and the Illinois Commerce Commission.
13

14 **Q. ARE YOU THE SAME DAVID ZIEGLER THAT PREVIOUSLY FILED**
15 **TESTIMONY IN THIS PROCEEDING?**

16 A. Yes. I pre-filed Direct Testimony in this proceeding on May 20, 2004.

17 **II. PURPOSE OF TESTIMONY**

18 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

19 A. The purpose of my testimony is to provide testimony in support of the Settlement
20 Agreement (the “Agreement”) as filed by the Arizona Corporation Commission

1 Staff in this Docket on August 23, 2005 among Qwest Corporation, the Arizona
2 Corporation Commission Staff, the Department of Defense and All Other Federal
3 Executive Agencies, the regulated subsidiaries of MCI, Inc., Time Warner
4 Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona
5 Telecom, LLC and XO Communications Services, Inc. regarding the consumer
6 benefits of the Agreement (Sections 13, 14, 15 and 16); the term of the
7 Agreement (Section 17); notice to consumers (Section 24); filing of tariffs and
8 price lists (Section 25); elimination of certain reporting requirements (Section 27);
9 and why the Settlement Agreement is in the public interest.

10 **Q. IS THE PROPOSED AGREEMENT IN THE PUBLIC INTEREST?**

11 A. Yes. The proposed Agreement is in the public interest because it provides
12 numerous consumer benefits while allowing Qwest to be regulated similarly to its
13 competitors. In his direct testimony in support of settlement, Qwest witness Mr.
14 Jerrold Thompson discusses additional reasons why this Agreement is in the
15 public interest. The Agreement is the result of many months and meetings
16 between the parties to develop a Renewed Price Cap Plan ("Plan") that balances
17 the needs of the Company, its competitors and consumers in an increasingly
18 competitive Arizona market.

III. CONSUMER BENEFITS

1

2 **Q. WOULD YOU PLEASE DESCRIBE THE CONSUMER BENEFITS IN THE**
3 **AGREEMENT?**

4 A. *The consumer benefits were designed to be statewide in scope, be meaningful,*
5 *and affect as many customers as possible. Several of the consumer benefits*
6 *affect all Qwest customers statewide. Those that benefit all customers are the*
7 *hard cap on basket 1 services as described in the testimony of Mr. Thompson, a*
8 *rate cap on directory assistance, and changes to the service quality tariff. Other*
9 *consumer benefits are more targeted benefits but are statewide nonetheless.*
10 *Those benefits consist of the reduction in zone charges, a reduction in residential*
11 *non-published and residential non-listed telephone listings, increased funding for*
12 *the Telephone Assistance Plan for the Medically Needy and increased line*
13 *extension credits. Although the benefit of certain provisions within the*
14 *Agreement cannot be quantified, the benefits that can be quantified total \$5.5*
15 *million.*

16 **Q. PLEASE DESCRIBE THE DIRECTORY ASSISTANCE CONSUMER BENEFIT.**

17 A. The directory assistance consumer benefit (Section 14) is a continuation of the
18 directory assistance benefit in the previous price cap plan in that it caps the
19 existing rate of \$1.15 per call rather than pricing directory assistance at the
20 higher market rate. It also includes one call allowance per month without charge,

1 two inquiries per usage and call completion. This benefit affects all Qwest
2 customers statewide.

3 **Q. PLEASE DESCRIBE HOW SERVICE QUALITY ISSUES AND THEIR**
4 **ASSOCIATED CONSUMER BENEFIT HAVE BEEN ADDRESSED IN THE**
5 **SETTLEMENT AGREEMENT.**

6 A. Section 15 of the proposed Settlement Agreement addresses service quality
7 issues in several ways. First, it contains incentives for Qwest to continue to
8 maintain the high service quality levels that it achieved during the term of the
9 initial price cap plan. Section 5 of the prior price cap plan contained a provision
10 for business and residence customers to receive a \$2.00 one-time credit during
11 any year in which Qwest became subject to penalties under two or more of the
12 five categories defined in Section 2.6 of the Service Quality Plan Tariff. Qwest's
13 performance under the prior plan resulted in no customer credits being issued.
14 The Renewed Price Cap Plan would carry over these provisions from the prior
15 plan and provide additional incentive for Qwest to maintain high levels of service
16 quality in addition to the competitive market incentives which exist in Arizona.

17 The second way in which the Agreement addresses service quality is by adopting
18 the recommendation from Staff Witness Del Smith's Direct Testimony to adjust
19 the penalty and offset ranges for Residence Office, Business Office, and Repair
20 Office Access. This provision will provide Qwest with a strong incentive to
21 perform satisfactorily because it will have the effect of increasing the ranges for

1 which penalties are assessed and decreasing the ranges for which penalty
2 offsets are received.

3 The third way in which the Agreement addresses service quality is by
4 establishing an additional objective for trouble reports. Pursuant to Section
5 2.5.6A of Qwest's Service Quality Tariff, the Company must not exceed 8 trouble
6 reports per 100 access lines per month, averaged over a 3 month period. Under
7 the terms of the Settlement Agreement, Qwest would modify its Service Quality
8 Tariff to further require that the Company not exceed 3 trouble reports per 100
9 access lines in any month, averaged over all of its Arizona Wire Centers. This
10 provides an additional incentive to minimize trouble reports that benefits
11 customers.

12 **Q. DOES THE AGREEMENT CONTAIN ANY OTHER SERVICE QUALITY**
13 **PROVISIONS?**

14 A. Yes. The Agreement also permits modifications to the Service Quality Tariff that
15 would clarify Qwest's obligations during conditions outside of its control. These
16 conditions, which are termed "Force Majeure", do not significantly change
17 Qwest's obligations, but provide greater clarity and include examples of events
18 for which Qwest would not be held responsible under the terms of the Tariff.

19 **Q. PLEASE DESCRIBE THE REDUCTION IN ZONE CHARGES.**

20 A. Zone charges reflect the fact that the farther a customer service location is from
21 the central office, the higher the cost of providing service to those customers. In

1 many exchanges statewide, there are two zones around the base rate area of the
2 exchange, Zone 1 and Zone 2. The Agreement (Section 13(a)) reduces the zone
3 charges by 50% for each zone. The current Zone 1 charge of \$1.00 will be
4 reduced to \$0.50 and the current Zone 2 charge of \$3.00 will be reduced to
5 \$1.50. Based on test year volumes, these reductions amount to \$2M annually.

6 **Q. PLEASE DISCUSS THE CONSUMER BENEFIT OF THE REDUCTION IN NON-**
7 **PUBLISHED AND NON-LISTED TELEPHONE NUMBER RATES FOR**
8 **RESIDENTIAL CUSTOMERS.**

9 A. The Agreement provides that Qwest shall reduce rates for residential Non-
10 Published and residential Non-Listed Telephone numbers (Section 13(b)) by
11 \$0.50. The current rates of \$1.65 for residential Non-Published numbers and
12 \$1.30 for residential Non-Listed numbers will be reduced to \$1.15 and \$.80,
13 respectively. Based on test year volumes, these reductions amount to \$2.5M
14 annually.

15 **Q, WOULD YOU PLEASE DESCRIBE THE CONSUMER BENEFIT OF THE**
16 **TELEPHONE ASSISTANCE PLAN FOR THE MEDICALLY NEEDY?**

17 A. The Agreement provides for an increase in funding for the Telephone Assistance
18 Plan ("TAP") for the Medically Needy of \$1.0 Million per year. Qwest is currently
19 providing \$1.0 million of annual funding for this plan and under the Agreement
20 that amount would increase to \$2.0 million per year. In combination with the
21 Federal Lifeline Program, the additional funding will pay the entire cost for basic

1 telephone service for up to approximately 7,200 new customers each year.
2 Under the Agreement, Qwest and DES will work together to develop a public
3 awareness program to increase participation in the TAP program.

4 **Q. PLEASE DESCRIBE THE LINE EXTENSION CREDIT BENEFIT.**

5 A. Qwest currently provides a one time credit of \$3,000 towards the cost of
6 establishing telephone service and constructing facilities to locations in rural
7 areas outside of the Base Rate Area of an exchange. The intent of this credit is
8 to offset some of the high construction costs that rural customers incur which are
9 the result of longer loop lengths and lower customer densities. The Settlement
10 Agreement increases the amount of the Line Extension credit to \$5,000 per
11 location. The higher Line Extension Credit amount will benefit customers living in
12 rural areas who according to Staff Witness Elijah Abinah's Direct Testimony, may
13 otherwise be unable to afford telephone service.

14 **IV. TARIFFS AND CUSTOMER NOTICE**

15 **Q. PLEASE DESCRIBE THE NOTICE TO CONSUMERS AND THE FILING OF**
16 **REVISED TARIFFS AND PRICE LISTS.**

17 A. Section 24 of the Settlement Agreement includes several provisions relating to
18 customer notices. First, Qwest has agreed to provide customers with two
19 separate bill inserts, the first to be sent beginning 60 days following entry of an
20 order approving the settlement, and the second to be sent 60 days after the first
21 bill insert. The notice is to inform customers of the following information:

- Services for which rates and charges may change without Commission approval.
- That essential basic services which are part of any packages or offering remain available and can be obtained by the customer as a separate offering.
- That the Arizona Corporation Commission remains the regulatory agency responsible for overseeing the terms, conditions, rates, and quality of intrastate telecommunications service provided by Qwest.
- Complaints regarding any of Qwest's regulated services should be directed to the Commission's Consumer Services Section.

Second, Qwest will provide training for its customer service representatives concerning the implementation of the Renewed Price Cap Plan.

Third, within 60 days from the effective date of the Renewed Price Cap Plan, Qwest will send a memorandum to organizations that assist persons with physical limitations which describes the exemption from Directory Assistance charges which is available to qualified persons with physical limitations that prevent them from using printed telephone directories. Qwest will also continue to provide this information in the red "Phone Service Pages" through its contractual arrangements with DEX.

V. REPORTS

Q. PLEASE DESCRIBE THE TWO REPORTS THAT ARE BEING ELIMINATED.

A. Section 27 of the Agreement provides for elimination of two reports that Qwest has been providing to the Commission. The first report is the deposit calculation

1 report, which was the result of a customer deposit complaint in 1992 and is no
2 longer an issue. The second report is the Public Access Line ("PAL") report.
3 This report was in place because at one time Qwest provided both payphone
4 service and PAL service. Qwest has since exited the payphone business,
5 thereby making the PAL report unnecessary.

6 **VI. TERM OF THE PLAN**

7 **Q. WOULD YOU PLEASE ADDRESS THE TERM OF THE PLAN?**

8 A. The term of the Plan is three years from the effective date specified by the
9 Commission in its order approving this Settlement Agreement and Renewed
10 Price Cap Plan. It will continue in its entirety until the Commission either
11 approves a renewed plan or terminates the Plan.

12 **VII. CONCLUSION AND RECOMMENDATION**

13 **Q. WHAT IS YOUR RECOMMENDATION REGARDING THE SETTLEMENT**
14 **AGREEMENT AND THE RENEWED PRICE CAP PLAN?**

15 A. My recommendation is that the Commission find that the Settlement Agreement
16 and Renewed Price Cap Plan are in the public interest and approve the
17 Settlement Agreement and Renewed Price Cap Plan as filed by the parties.

18 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

19 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF ARIZONA
COUNTY OF MARICOPA

AFFIDAVIT OF
DAVID L. ZIEGLER

SS

David L. Ziegler, of lawful age being first duly sworn, deposes and states:

1. My name is David L. Ziegler. I am Assistant Vice President – Arizona Public Policy for Qwest Services Corporation in Phoenix, Arizona. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.


David L. Ziegler

SUBSCRIBED AND SWORN to before me this 6th day of September, 2005.


Notary Public

My Commission Expires: March 15, 2008



DEBORAH L. STATT
Notary Public – Arizona
Maricopa County
Expires 03/15/08

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S)	
FILING OF RENEWED PRICE REGULATION)	DOCKET NO. T-01051B-03-0454
PLAN)	
)	
IN THE MATTER OF THE INVESTIGATION OF)	
THE COST OF TELECOMMUNICATIONS)	DOCKET NO. T-00000D-00-0672
ACCESS)	
)	
)	

JERROLD L. THOMPSON

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

TESTIMONY INDEX

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EXECUTIVE SUMMARY

My testimony provides a description of the pricing flexibility afforded Qwest by the terms and conditions of the Settlement Agreement and Price Plan negotiated by the parties. Under the terms of the Agreement, Qwest has agreed to price constraints, price reductions, and overall revenue constraints from rate increases in exchange for the opportunity to raise or adjust prices for its competitive services.

Telecommunications is a very complex and competitive business in many parts of Arizona. This Settlement Agreement and Price Plan are the product of thorough consideration and careful balancing of the complex issues raised by the parties to the Agreement which include the Commission Staff, Qwest, local competitors (Cox, MCI, Time Warner, and XO), customers (Department of Defense and All Other Federal Executive Agencies), and investors (AUIA). I recommend that the Commission approve the Settlement Agreement and the Price Plan as submitted by the Parties.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jerrold L. Thompson. My business address is Room 4740, 1801 California Street, Denver, CO.

Q. WHAT IS YOUR POSITION WITH QWEST AND WHAT ARE YOUR RESPONSIBILITIES?

A. My title is Executive Director of Retail Issues in Qwest Service Corporation's Public Policy organization. In that position I direct and coordinate the company advocacy in matters relating to the manner in which Qwest Corporation ("Qwest") is regulated for retail services. These matters include regulatory reform in dockets before commissions and changes to laws with state legislatures.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE?

A. I have a Bachelor of Arts Degree in English and a Master of Business Administration Degree with a concentration in Accounting, both from the University of New Mexico. I have a Master of Taxation Degree from the College of Business and the School of Law of the University of Denver. I hold an inactive certificate as a Certified Public Accountant from the states of New Mexico and Colorado. I began working for Mountain Bell (now Qwest) in 1979 and have held numerous positions in industry relations, finance and accounting, costing and pricing, and public policy.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN ARIZONA?

A. Yes. Although I have not filed testimony in this docket prior to this testimony, I have provided testimony before the Arizona Corporation Commission ("Commission") on several occasions in the past including the rate case in 1994 (E-1051-93-183) and the rate case in 2000 (T-0105B-99-0105).

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. My testimony is organized into four topics, Competitive Zones and Universal Service, Operation of Baskets, Pricing and Deregulation of Voice Messaging and Billing and Collection services.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony addresses the agreement among Qwest Corporation ("Qwest"), the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies ("DOD"), the regulated subsidiaries of MCI, Inc. ("MCI"), Time Warner Telecom of Arizona, LLC ("TW"), the Arizona Utility Investors Association ("AUIA"), Cox Arizona Telcom, LLC ("Cox"), and XO Communications Services, Inc. ("XO"), (collectively "the Parties") to a settlement of the pending Qwest application for renewal of its Price Cap Plan with modifications. Specifically, my testimony explains various aspects of the proposed Settlement Agreement ("Agreement") and alternative form of regulation plan ("the Plan") that is supported by the Parties as filed by Maureen

1 Scott, Staff attorney on August 23, 2005. My testimony discusses several
2 aspects of the Plan in detail. My testimony, along with the testimonies of Qwest
3 witnesses Mr. David Ziegler and Mr. Philip Grate, detail the reasons why the
4 Commission should approve the Agreement and Plan as proposed by the
5 Parties.

6 **III. SETTLEMENT AGREEMENT**

7 **Q HOW DO YOU VIEW THE SETTLEMENT AGREEMENT?**

8 A. In my view, the Agreement proposes a thoroughly considered and thoughtfully
9 balanced plan of alternative regulation that includes targeted benefits for
10 consumers, recognition of the increasingly competitive market for
11 telecommunications services in Arizona, incentives for Qwest to offer new and
12 different competitive consumer choices, resolution of complex accounting issues,
13 elimination of certain legal disputes, reductions in rates for Qwest's services
14 purchased by its customers and its competitors, and movement toward cost-
15 saving reductions in regulatory requirements. In sum, the Plan is in the public
16 interest and should be approved by the Commission.

17 **Q. WHICH AREAS OF THE AGREEMENT AND PLAN DOES YOUR TESTIMONY**
18 **ADDRESS?**

19 A. My testimony discusses the areas of Pricing, Operation of the Service Baskets,
20 and the mechanics of the Agreement and Plan. Mr. Ziegler addresses the
21 consumer benefits that have been incorporated into the Agreement and Plan and

1 Mr. Grate's testimony discusses the financial and accounting aspects of the
2 Agreement and Plan.

3 **IV. COMPETITIVE ZONES AND UNIVERSAL SERVICE FUNDS**

4 **Q. IN ITS DIRECT TESTIMONY QWEST PROPOSED THE USE OF**
5 **COMPETITIVE ZONES AND REQUESTED FUNDS FROM THE STATE**
6 **UNIVERSAL SERVICE FUND. HOW ARE THOSE TWO ISSUES ADDRESSED**
7 **IN THE SETTLEMENT AGREEMENT?**

8 A. In the process of negotiation, Qwest agreed to withdraw its request for
9 competitive zones and not renew its request during the term of the Plan
10 (Agreement, Section 26). Qwest also agreed to withdraw its request for Arizona
11 Universal Service funds and to decrease its allowable revenue limits by a pro-
12 rata share of any amounts of federal or state universal service funds received
13 during the term of the Plan (Agreement, Section 19).

14 Competitive zones were a controversial topic in the direct testimony in this
15 proceeding with very disparate points of view. The elimination of this issue
16 removes this controversy. Qwest will continue to price its services to consumers
17 in sparsely-populated areas in the state in similar ways to consumers in the
18 highly competitive areas of Phoenix and Tucson. In other words, whatever
19 consumer friendly action Qwest takes to compete in Phoenix and Tucson will be
20 enjoyed by its customers in all other parts of Arizona whether those areas have
21 the same level of competition or not.

1 During the course of the negotiations, the Commission solicited comments from
2 interested parties concerning rule changes proposed by the Arizona Local
3 Exchange Carriers Association in Docket No. RT-00000H-97-0137, *In the Matter*
4 *of Review and Possible Revision of the Arizona Universal Service Fund Rules*.
5 In the spirit of compromise, and in recognition of the fact that the rules for the
6 operation of the fund could change as a result of the above docket, Qwest
7 agreed to withdraw its request for \$64 million of funding in this proceeding.
8 Qwest is participating in Docket No. RT-00000H-97-0137 and could potentially
9 qualify for universal service funding during the first three years of the Plan in that
10 rulemaking. Qwest has agreed however, that any additional funding for universal
11 service during the first three years of the Plan, whether from the state or federal
12 jurisdictions, would result in a pro-rata decrease to the revenue opportunity
13 established in the Plan (Agreement, Section 19).

14 V. OPERATION OF BASKETS

15 A. BASKET 1

16 Q. PLEASE EXPLAIN HOW THE PLAN SEPARATES SERVICES INTO
17 DIFFERENT CATEGORIES AND HOW BASKET 1 IS TREATED IN THE PLAN.

18 A. The Plan creates four categories, or "baskets", of services provided by Qwest.
19 All tariffed and price listed services are categorized in one of the Baskets.
20 Basket 1 contains those services that are termed "Hard capped", Basket 2
21 contains those services allowed Limited Price Flexibility and Basket 3 consists of

1 Flexibly Priced Competitive Services. Basket 4 includes tariffed wholesale
2 services.

3 Basket 1 consists of basic services whose prices will not be allowed to increase
4 over the three year term of the Plan. These services include primary line flat-rate
5 service to residence and business customers, low use option service, toll
6 restriction, exchange zone increment charges, residence non-published and non-
7 listed service, telephone assistance programs, and other miscellaneous services
8 (Agreement, Section 12 and Appendix A-1). Prices for these Basket 1 services
9 may be reduced but they may not be increased during the three year term of the
10 Plan.

11 **B. BASKET 2**

12 **Q. HOW DOES THE PLAN REGULATE BASKET 2 SERVICES?**

13 A. The Plan acknowledges that competition has increased in Arizona since the prior
14 plan and that the Plan should recognize degrees of relaxation of regulation. As
15 such, a number of services were reviewed and agreed upon as services for
16 which a limited amount of price flexibility should be allowed. These services
17 include discretionary services such as central office vertical features and some
18 complex business services (Agreement Section 12, and Appendix A-2). Prices
19 for these services may be increased, but no more than 25% per year, and no
20 more than the established aggregate limits (see Opportunity for Price Change
21 below).

C. BASKET 3

Q. HOW DOES THE PLAN REGULATE BASKET 3 SERVICES?

A. Basket 3, Flexibly-Priced Competitive Services, consists of services that have been accorded pricing flexibility or have been determined by the Commission to be competitive under Commission Rule R14-2-1108 (Agreement Section 12, and Appendix A-3). Basket 3 also includes new services and packages of services offered by Qwest.¹ Individual price increases for these services are not limited but the combined revenue increase opportunity for all services in this Basket is subject to the established limit (see Opportunity for Price Change below).

D. BASKET 4

Q. HOW DOES THE PLAN REGULATE BASKET 4 SERVICES?

A. Basket 4, Wholesale Services, contains services provided to other providers of service in Arizona. Local access services to long distance companies, interconnection services, services to pay phone providers, and other miscellaneous services are included in this category (Agreement Section 12, and Appendix A-4). The Plan requires that these services be capped at the tariffed or contract price levels for the three year term of the Plan, or until contracts are re-negotiated, or the FCC, the Commission or the courts determine that other prices are appropriate.

¹ As part of the Agreement, Qwest agrees to make individual elements of its packages available on an a la carte basis and that the price of a package shall be no higher than the sum of the highest price of its a la carte prices of the services available for the package.

1 The Plan does provide for a decrease in intrastate switched access prices. This
2 provision is discussed in greater detail in the next section of my testimony.

3 **VI. PRICING**

4 **A. APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT**

5 **Q. WHAT WAS THE COMMISSION DECISION REGARDING THE APRIL 1, 2005**
6 **PRODUCTIVITY ADJUSTMENT FROM THE PRIOR PLAN?**

7 **A.** In its Decision No. 67734, the Commission made the following statement:

8 "We agree with RUCO that based on the terms of the current Price Cap Plan,
9 and our holdings in Decision Nos. 66772 and 67047 that unless we approve a
10 new Plan or terminate the current Plan, Qwest is required under the
11 Continuation Clause of the Plan to make the April 1, 2005 productivity
12 adjustment."

13 Further the Commission stated:

14 "Qwest has the burden of demonstrating that the terms of any Renewed Plan
15 or other form of rate regulation that may ultimately be approved, whether
16 produced by settlement or through litigation, include credit for the full value of
17 the April 1, 2005 productivity adjustment being given to ratepayers."

18 **Q. HOW DOES THE AGREEMENT ADDRESS THESE COMMISSION**
19 **DECISIONS?**

20 **A.** The Parties agree that Qwest's obligation under Decision No. 67734 is satisfied
21 by a \$12 million reduction to the allowable revenue from price changes for the
22 first year of the Plan (Agreement, Section 7). Without this provision, Qwest
23 would otherwise have the opportunity to raise rates by an additional \$12 million

1 the first year of the Plan. By reducing Qwest's opportunity to raise its rates,
2 Qwest is being denied the opportunity to earn its fair rate of return for one year.
3 \$12 million is the one-year value of the productivity adjustment and therefore
4 represents the "full value" of that adjustment as provided in the prior plan.

5 **B. SWITCHED ACCESS**

6 **Q. WHAT IS THE SWITCHED ACCESS COMPONENT OF THE SETTLEMENT**
7 **AGREEMENT?**

8 A. The Commission determined that Phase I of the docket *In the Matter of the*
9 *Investigation of the Cost of Telecommunications Access*, should be considered in
10 conjunction with the renewed Plan. Thus, Docket No. T-00000D-00-0672 was
11 consolidated with Docket No. T-01051B-03-0454. Under the Agreement, Qwest
12 will make a \$12 million (annualized) reduction to its switched access prices.
13 Specifically, under the terms of this Agreement Qwest will reduce its Carrier
14 Common Line rate for originating traffic from \$0.006244 to \$0.00, its Carrier
15 Common Line rate for terminating traffic from \$0.014153 to \$0.00, and its
16 Interconnection charge from \$0.00245 to \$0.00. The reduction in switched
17 access revenue of \$12 million is accompanied by price increases in other
18 services for an equivalent amount of revenue as discussed in the Opportunity for
19 Price Change section of my testimony. The Parties agree that the reduction in
20 switched access prices satisfies the issue of Qwest's access rates for the three
21 year term of the Plan (Agreement, Section 8).

C. SPECIAL ACCESS

Q. WHAT IS THE SPECIAL ACCESS COMPONENT OF THE SETTLEMENT AGREEMENT?

A. During the negotiations, Qwest agreed to provide, under the conditions of its Competitive Private Line Transport Services Tariff, a custom offer of intrastate DS-1 service that meets the specific needs of Parties to this Agreement. The offer is found as Attachment D to the Agreement. This offer, subject to the approval of the Agreement and Plan by the Commission, allows these and other similarly situated carriers a three-year volume-commitment arrangement at discounted prices (Agreement, Section 9).

D. OPPORTUNITY FOR PRICE CHANGES

Q. PLEASE EXPLAIN THE OPPORTUNITY FOR PRICE CHANGES THAT IS PART OF THE AGREEMENT AND PLAN.

A. Part of the Agreement, as described by Qwest witness Mr. Philip Grate, is the recognition that Qwest has an Arizona revenue deficiency of \$31.8 million. The Parties to the Agreement have agreed that Qwest should be granted the opportunity to adjust certain of its rates during the term of the Plan to correct this deficiency. Because of the \$12 million April 1, 2005 adjustment condition in the Plan, Qwest will not be allowed to increase its rates for services listed in Baskets 2 or 3 more than \$31.8 in the first year of the Plan (\$31.8 million less \$12 million for the April 1, 2005 issue, plus \$12 million to offset the switched access price

1 reduction). In the years following the first year of the Plan, the maximum amount
2 allowed to Qwest would be a cumulative total of \$43.8 million (\$31.8 million
3 revenue deficiency plus the \$12 million to offset the switched access price
4 reduction). It is the position of the Parties that this pricing flexibility results in just
5 and reasonable rates for Qwest's intrastate operations (Agreement, Section 10).

6 ***E. ALLOCATION OF OPPORTUNITY***

7 **Q. THERE IS ALSO A PROVISION IN THE AGREEMENT THAT THE**
8 **OPPORTUNITY FOR PRICE CHANGES IS FURTHER LIMITED BY AN**
9 **ALLOCATION BETWEEN BASKET 2 AND BASKET 3 SERVICES. PLEASE**
10 **ELABORATE.**

11 **A.** The \$31.8 million increased revenue opportunity during the first year of the Plan
12 is allocated between Basket 2 and Basket 3 services such that no more than
13 \$1.8 million is allowed from Basket 2 services. For years 2 and 3, no more than
14 a cumulative \$13.8 million is allowed from Basket 2 services. The portion of the
15 revenue opportunity not used for Basket 2 is allocated to Basket 3, Flexibly-
16 Priced Competitive Services.

F. OTHER PRICING PROVISIONS

Q. WHAT OTHER PRICING PROVISIONS ARE INCLUDED IN THE PLAN?

A. Other provisions include agreement by the Parties that the Commission's rules on imputation do not need to be changed at this time and that Qwest be allowed to introduce promotional offerings upon one day notice to the Commission.

VII. DEREGULATION OF VOICE MESSAGING AND BILLING & COLLECTION

Q. WHAT RECOMMENDATION DOES THE PLAN HAVE FOR VOICE MESSAGING SERVICE AND BILLING AND COLLECTION SERVICES?

A. The Parties agree on deregulation of both Voice Mail Service and Billing and Collection Services. The Parties recommend that the Commission approve the deregulation of these services.

VIII. CONCLUSION AND RECOMMENDATION

Q. COULD YOU PLEASE PROVIDE YOUR CONCLUSION AND RECOMMENDATION TO THE COMMISSION?

A. The Agreement and Plan presented to the Commission contain many benefits. Several consumer benefits are described by the testimony of Mr. Ziegler. The benefits my testimony covers range from price stability for basic residence and business consumers, sharing competitive incentives with both urban and rural customers, foregoing revenue increases for the first year of the Plan (for the April

1 2005 adjustment), reducing switched access rates for long distance carriers,
2 offering term and volume discounts for competitive special access services,
3 limiting price increases for all three years of the Plan, and getting promotional
4 discounts to customers quicker. The Plan is very comprehensive in its design
5 and is supported by all of the signing Parties. I recommend that the Commission
6 approve the Plan as presented.

7 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

8 **A. Yes.**

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF COLORADO
COUNTY OF DENVER

AFFIDAVIT OF
JERROLD L. THOMPSON

SS

Jerrold L. Thompson, of lawful age being first duly sworn, deposes and states:

1. My name is Jerrold L. Thompson. I am Executive Director of Retail Issues for Qwest Services Corporation in Denver, Colorado. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

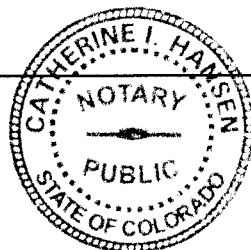
Further affiant sayeth not.

Jerrold L. Thompson
Jerrold L. Thompson

SUBSCRIBED AND SWORN to before me this 31st day of August, 2005.

Catherine I. Hansen
Notary Public

My Commission Expires: _____



My Commission Expires July 25, 2008

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman

WILLIAM A. MUNDELL

MARC SPITZER

MIKE GLEASON

KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN))))	DOCKET NO. T-01051B-03-0454
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS))))	DOCKET NO. T-00000D-00-0672

PHILIP E. GRATE

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

PUBLIC VERSION

TESTIMONY INDEX

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EXECUTIVE SUMMARY

In reaching an Agreement, the parties stipulated to the amount of the fair value rate base, the rate of return on fair value rate base, the incremental revenue requirement (revenue deficiency) and the regulatory accounting Qwest is to use in future Arizona ratemaking to account for depreciation, other post-employment benefits and internal use software. The depreciation lives and methods that the Agreement prescribes reduce Qwest's test year depreciation expense 57% and will continue to be used in the future. Agreement on these key ratemaking and regulatory accounting issues allowed the parties to settle and avoid possibly protracted litigation. The revenue deficiency amounts that the parties advocated and that the Agreement stipulates are as follows:

Qwest	RUCO	Staff	Agreement
\$355.4 million	\$159.5 million	\$3.5 million	\$31.8 million

Qwest has agreed to expanded reporting obligations whereby it will provide Staff separated results of operations annually. Qwest also agreed to file a rate case if its application for extension, renewal or termination of the Renewed Price Cap Plan contemplates increasing Arizona intrastate revenues more than a de minimis amount above the increased revenues that the parties agreed upon as part of this Agreement and that are permitted by the Renewed Price Cap Plan.

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Philip E. Grate. My business address is Qwest Corporation, 1600 7th Avenue, Seattle, Washington.

Q. ARE YOU THE SAME PHILIP E. GRATE WHO FILED DIRECT, REBUTTAL AND REJOINDER TESTIMONY IN THIS PROCEEDING?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT?

A. This testimony addresses the agreement among Qwest Corporation ("Qwest"), the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies, the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telcom, LLC, and XO Communications Services, Inc., (collectively "the Parties") to a Settlement Agreement ("Agreement") of the pending Qwest application for renewal of its current Price Cap Plan with modifications. Specifically I describe and explain the portions of the Agreement that pertain to cost-

1 of-service ratemaking issues, Arizona jurisdictional accounting and reporting issues,
2 and filing for renewal.

3 **III. STIPULATED COST-OF-SERVICE ISSUES**

4 **Q. DID THE PARTIES STIPULATE TO COST-OF-SERVICE ISSUES IN THE**
5 **AGREEMENT?**

6 A. Yes. The parties stipulated to the following cost-of-service issues:

- 7 • Fair Value Rate Base
8 • Rate of Return on Fair Value Rate Base
9 • Revenue Deficiency
10 • Jurisdictional accounting for Software, OPEBs, and Depreciation.

11 **Q. WHY DOES THE AGREEMENT PROVIDE FOR SPECIFIC RESOLUTION OF**
12 **THESE ISSUES AND NOT OTHERS?**

13 A. In testimony, Staff argued that Qwest should agree to disagree on any number of
14 ratemaking issues that do not impact the overall level of rate relief sought by Qwest
15 and that Qwest should narrow the scope of the case to address only those issues
16 that actually require a Commission finding to successfully conclude the proceeding.¹
17 The Agreement accomplishes this objective. It stipulates to those issues of
18 ratemaking—rate base, rate of return and incremental revenue requirement
19 (revenue deficiency)—upon which the Commission ordinarily makes findings of fact
20 in rate cases, by agreeing on values but expressly not agreeing on treatment of a

¹ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 4.

1 number of ratemaking issues. However, the Agreement does stipulate to the
2 treatment of three accounting issues that require a Commission decision so as to
3 make clear the Arizona jurisdictional accounting to be followed in the conduct of any
4 future Qwest rate cases and to be used in expanded annual Arizona financial
5 reporting that the Company has agreed to provide.

6 **Q. WHAT DOES THE AGREEMENT PROVIDE WITH REGARD TO RATE BASE,**
7 **RATE OF RETURN AND REVENUE DEFICIENCY?**

8 A. In pertinent part, section 1 of the Agreement provides:

9 "For ratemaking purposes, and in accordance with the terms of this Agreement,
10 the Parties agree that the "fair value" of Qwest's Arizona rate base for the test
11 year ending December 31, 2003 (the "Test Year") is \$1,507,745,000. For
12 ratemaking purposes and for purposes of this Agreement, the Parties agree that
13 a reasonable return on the fair value of that rate base is 9.5%."

14 Section 2 of the Agreement provides:

15 "For ratemaking purposes and in accordance with the terms of this Agreement,
16 the Parties agree that Qwest's jurisdictional revenue deficiency is \$ 31.8 Million."
17 [footnote omitted]

Q. HOW DO THE AMOUNTS FOR RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY SET FORTH IN THE AGREEMENT COMPARE WITH THE POSITIONS OF THE PARTIES IN TESTIMONY?

A. The following table compares the amounts specified in the Agreement with the positions of those Parties that filed testimony concerning rate base, rate of return and revenue deficiency.

	Qwest	RUCO	Staff	Agreement
Original Cost:				
Rate Base	\$1,717 M	\$1,489 M	\$1,560 M	NA
Rate of Return	11.18%	8.73%	9.50%	NA
Revenue Deficiency	\$275.0 M	\$159.5 M	\$3.5 M	NA
Fair Value:				
Rate Base	\$2,141 M	\$2,285 M	\$2,229 M	\$1,508 M
Rate of Return	11.18%	5.69%	6.65%	9.50%
Revenue Deficiency	\$355.4 M	\$159.5 M	\$3.5 M	\$31.8 M

Q. HOW DID THE PARTIES ARRIVE AT THE AMOUNTS FOR FAIR VALUE RATE BASE, RATE OF RETURN AND REVENUE DEFICIENCY REFLECTED IN THE AGREEMENT?

A. The amounts in the Agreement reflect the Parties' compromise of the many contested issues in this case. The compromise was negotiated as an indivisible part of the overall agreement to settle. The parties did not stipulate any agreement on a

1 number of contested ratemaking issues in the case. I call these issues "unstipulated
2 ratemaking issues" in recognition of the fact that the Parties have not resolved how
3 such issues should be treated for ratemaking purposes—they have only
4 compromised on aggregate settlement values.

5 **Q. PLEASE EXPLAIN HOW THE REVENUE DEFICIENCY IDENTIFIED IN THE**
6 **AGREEMENT DIFFERS FROM QWEST'S CALCULATION OF THE REVENUE**
7 **DEFICIENCY.**

8 A. The difference between the \$355.4 million revenue deficiency that Qwest advocated
9 in testimony and the \$31.8 million revenue deficiency stipulated in the Agreement is
10 \$323.6 million. The following schedule quantifies the elements of the \$323.6 million
11 difference:

12 Stipulated jurisdictional accounting issues	\$ (170.0) million
13 Stipulated rate of return on original cost rate base	\$ (49.8) million
14 Unstipulated ratemaking issues	<u>\$ (103.8) million</u>
15 Total revenue deficiency difference	\$ (323.6) million

1 **IV. STIPULATED JURISDICTIONAL ACCOUNTING ISSUES**

2 **A. *Stipulation on Accounting for Internal-Use Software***

3 **Q. WHAT ISSUE REGARDING ACCOUNTING FOR INTERNAL-USE- SOFTWARE**
4 **WAS CONTESTED IN THIS CASE?**

5 A. The issue that Staff, Qwest and RUCO contested is whether accrual accounting for
6 internal-use computer software in accordance with the American Institute of Certified
7 Public Accountants' Statement of Position 98-1 (SOP 98-1) was incorporated into
8 Arizona regulatory accounting and Qwest ratemaking in 1999 when the FCC
9 incorporated SOP 98-1 into the Uniform System of Accounts (USOA). Qwest and
10 RUCO testified that it was.² Staff's testimony argues that it was not and treats SOP
11 98-1 as adopted in the 2003 test year.³

12 **Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING**
13 **FOR INTERNAL-USE- SOFTWARE?**

14 A. The Agreement reflects a compromise of the parties' positions and assumes that
15 SOP 98-1 was adopted at the beginning of the year 2001, the year in which Qwest's
16 current Price Cap Plan became effective pursuant to Commission Decision No.
17 63487. Specifically, Section 3 of the Agreement provides:

² Docket No. T-01051B-03-0454: Direct Testimony of Marylee Diaz Cortez, page 6, line 20 to page 7, line 11; Rebuttal Testimony of Philip E. Grate, pages 23 through 32; Surrebuttal Testimony of Marylee Diaz Cortez, page 3, line 4 to line 16.

³ Docket No. T-01051B-03-0454, Direct Testimony of Steven C. Carver; page 45, line 8 to page 56 line 2.

1 "[W]ith respect to calculating Qwest's rate base and revenue requirement, Qwest
2 shall be treated as having adopted on January 1, 2001 the American Institute of
3 Certified Public Accountants' Statement of Position 98-1 ("SOP 98-1") to account
4 for the costs of internal use computer software, effective January 1, 2001."

5 Applying the assumptions employed in the Agreement instead of the assumptions
6 Qwest and RUCO made with regard to this jurisdictional accounting issue reduces
7 Qwest's calculated revenue requirement \$30.6 million.⁴ A schedule showing this
8 revenue requirement effect is set forth in Qwest Corporation—Exhibit PEG-S01.

9 ***B. Stipulation on Accounting for OPEBs***

10 **Q. WHAT IS OPEBS?**

11 A. OPEBs is an acronym for other post-employment benefits.

12 **Q. WHAT ISSUE REGARDING ACCOUNTING FOR OPEBS WAS CONTESTED IN**
13 **THIS CASE?**

14 A. The issue that Staff, Qwest and RUCO contested is whether Qwest's use of accrual
15 accounting for OPEBs under Statement of Financial Accounting No. 106 (SFAS 106)
16 began for Arizona ratemaking purposes in 1999. Staff argues that it did.⁵ Qwest
17 and RUCO believe that it did not and that Qwest continues to operate under the

⁴ The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.

⁵ Docket No. T-01051B-03-0454, Direct Testimony of Steven C. Carver; page 56 line 4 to page 71, line 13.

1 cash (or "pay-as-you-go") method of accounting⁶ that the Commission ordered
2 Qwest to continue using in Qwest's last fully litigated rate case.⁷

3 **Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING**
4 **FOR OPEBS?**

5 A. The Agreement reflects a compromise of the parties' positions and assumes that
6 SFAS 106 was adopted when Qwest's current Price Cap Plan became effective
7 concurrent with the effective date of Commission Decision No. 63487, which was
8 April 1, 2001. Specifically, Section 3 of the Agreement provides:

9 "For settlement purposes, the Parties agree that with respect to calculating
10 Qwest's revenue requirement, Qwest shall be treated as having adopted on April
11 1, 2001, Statement of Financial Accounting Standards ("SFAS") 106 to account
12 for Other Post Employment Benefits ("OPEBs"), with a ten year amortization of
13 Qwest's December 31, 2000 Accumulated Post-Retirement Benefit Obligation
14 ("APBO") starting April 1, 2001."

15 Applying the assumptions employed in the Agreement instead of the assumptions
16 Qwest and RUCO made with regard to this issue reduces Qwest's calculated
17 revenue requirement \$19.8 million.⁸ The calculation of this revenue requirement
18 effect is set forth in Qwest Corporation—Exhibit PEG-S01.

⁶ Docket No. T-01051B-03-0454: Direct Testimony of Philip E. Grate, page 54, line 7 through page 56; Rebuttal Testimony of Philip E. Grate, pages 15 through 23; Surrebuttal Testimony of Marylee Diaz Cortez, page 8, line 1 to line 11.

⁷ A.C.C. Decision No. 58927, page 7, lines 9 through 19 and page 40, line 20 through page 45, line 5.

⁸ The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.

1 **C. Stipulation on Accounting for Depreciation**

2 **Q. WHAT ISSUE REGARDING ACCOUNTING FOR DEPRECIATION WAS**
3 **CONTESTED IN THIS CASE?**

4 A. The issue that Staff, Qwest and RUCO contested is whether Qwest's depreciation
5 rates should be based on the lives and survivor curves the Commission prescribed
6 in Decision No. 62507 on May 4, 2000 in Qwest's last depreciation case⁹ or on
7 newly prescribed lives and survivor curves. Qwest¹⁰ and RUCO¹¹ testified that the
8 depreciation rates should reflect a technical update of the lives the Commission
9 prescribed in Decision No. 62507 while Staff proposed the use of longer lives.¹²

10 **Q. WHAT DOES THE AGREEMENT STIPULATE WITH REGARD TO ACCOUNTING**
11 **FOR DEPRECIATION?**

12 A. In pertinent part, Section 4 of the Agreement provides:

13 "The Parties agree that Qwest will use the depreciation rates and amortizations
14 shown on Attachment B. This results in approximately a \$255 Million reduction in
15 the annual intrastate depreciation expense for each year of the first five years,
16 and approximately a \$225 million annual reduction below the test year level in
17 the intrastate depreciation expense thereafter."

18 The rates and amortizations shown on Attachment B reflect substantially longer
19 projection lives than those the Commission prescribed in Qwest's last depreciation

⁹ Docket No T-01051B-97-0689.

¹⁰ Docket No. T-01051B-03-0454, Direct Testimony of Dennis Wu, page 2, lines 1 through 9.

¹¹ Docket No. T-01051B-03-0454, Direct Testimony of Marylee Diaz Cortez, page 23, lines 12 through 16.

¹² Docket No. T-01051B-03-0454, Direct Testimony of William A. Dunkel, page 27, line 18 to page 38, line 6.

case. The result of these longer lives and other changes to which Qwest agreed decrease Qwest's unadjusted 2003 test year Arizona intrastate depreciation expense by 57%. Qwest's use of the longer lives will be ongoing.

Q. HOW DOES THE DEPRECIATION EXPENSE REDUCTION PRESCRIBED BY THE AGREEMENT COMPARE WITH THE DEPRECIATION EXPENSE REDUCTION THAT STAFF PROPOSED IN TESTIMONY?

A. The following table sets forth the amount of Arizona intrastate depreciation expense change proposed by Qwest and Staff, and the amount prescribed by the Agreement.

Proposed Test Year Depreciation Expense Adjustment

Qwest	Staff	Agreement
(\$155) million	(\$253) million	(\$257) million

As the table shows, the Agreement calls for a \$4 million greater reduction in depreciation expense than Staff proposed. The reduction in test year depreciation expense prescribed in the Agreement reduces Qwest's calculated revenue requirement \$119.6 million.¹³ A schedule showing this revenue requirement effect is set forth in Qwest Corporation—Exhibit PEG-S01.

¹³ The assumptions used to compute this amount include the 9.5% rate of return to which the parties agreed in the Agreement and the revenue multiplier that Staff advocated in testimony.

V. STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE

Q. PLEASE EXPLAIN THE STIPULATED RATE OF RETURN ON ORIGINAL COST RATE BASE.

A. Arizona Administrative Code (A.A.C.) R14-2-4-103 calls for the filing of two different calculations of rate base, one on the original cost basis and one on a fair value basis. Using an 11.18% rate of return on its calculation of original cost rate base, Qwest calculated a revenue deficiency of \$275.0 million. Substituting the 9.5% rate of return stipulated in the Agreement for the 11.18% that Qwest used reduces Qwest's calculated revenue deficiency by \$49.8 million. A schedule showing this revenue requirement effect can be found in Qwest Corporation—Exhibit PEG-S01.

The 9.5% rate of return is the same as the rate of return Staff applied to its calculation of original cost rate base.

VI. UNSTIPULATED RATEMAKING ADJUSTMENTS

Q. PLEASE EXPLAIN THE UNSTIPULATED RATEMAKING ADJUSTMENTS.

A. Staff and Qwest contested a variety of ratemaking issues upon which they reached no stipulation or agreement. The parties reserve their right to contest these unstipulated ratemaking issues in any future Arizona ratemaking proceedings. Specifically, footnote 1 of the Agreement provides:

1 "The agreements set forth in Sections 1 and 2 regarding the quantification of fair
2 value rate base, a reasonable rate of return and the amount of the revenue
3 deficiency are made for purposes of settlement only. The Parties stipulate that
4 the agreements regarding quantification of fair value rate base, a reasonable rate
5 of return, revenue requirement, and revenue deficiency should not be construed
6 as admissions against interest or waivers of litigation positions or claims by any
7 Party relating to the calculation of these amounts. The Parties also stipulate that
8 except as specifically set forth in Sections 3 and 4 of the Agreement, each Party
9 reserves the right to pursue its advocacy in regard to any such controversy in
10 other proceedings."

11 Sections 3 and 4 of the Agreement address the stipulated jurisdictional accounting
12 issues, which the parties have agreed not to contest in future ratemaking
13 proceedings. The difference between the Agreement's calculation of revenue
14 requirement and Qwest's calculation of revenue requirement attributable to
15 unstipulated ratemaking issues is \$103.8 million. A schedule setting forth this
16 revenue requirement effect can be found in Qwest Corporation—Exhibit PEG-S01.

17 **VII. EXPANDED REPORTING OBLIGATIONS**

18 **Q. DOES THE SETTLEMENT AGREEMENT EXPAND QWEST'S FINANCIAL**
19 **REPORTING OBLIGATIONS?**

20 **A. Yes. In pertinent part, Section 3 of the Agreement provides:**

21 "The Parties agree that Qwest will provide Staff with a confidential copy of its
22 year-to-date December 1990s report for Arizona, prepared in the normal course
23 of business, or any substantively identical replacement. Qwest will provide this
24 report at the same time it files its annual report with the Commission. Staff will
25 treat the 1990s report as confidential, the same treatment required under
26 Commission rules for its annual report."

1 Qwest Corporation—Confidential Exhibit PEG-S02 provides examples (showing
2 calendar years 2001 through 2004) of the annual reporting that Qwest will provide in
3 accordance with Section 3 of the Agreement.

4 **Q. WHY IS THE PROVISION OF THE 1990S REPORT FOR ARIZONA AN**
5 **EXPANSION OF QWEST'S REPORTING OBLIGATIONS?**

6 A. The 1990's report provides separated results of operations. The Commission's rules
7 do not call for the regular periodic filing of separated results of operations. Qwest
8 does not routinely provide this information except as part of a rate case filing under
9 A.A.C. R14-2-103.

10 **VIII. EXPANDED RENEWAL OBLIGATIONS**

11 **Q. DOES THE SETTLEMENT AGREEMENT EXPAND QWEST'S OBLIGATIONS WITH**
12 **REGARD TO THE FILING OF AN APPLICATION FOR EXTENSION, REVISION**
13 **OR TERMINATION OF THE PLAN?**

14 A. Yes. At Section 18, the Agreement contains essentially all of the filing requirements
15 for extension, revision or termination of the Renewed Price Cap Plan that are found
16 in Qwest's current Price Cap Plan. However, the Agreement also adds a new
17 obligation to file a rate case under certain circumstances. In pertinent part, Section
18 18 of the Agreement provides:

19 "Qwest shall initiate extension, revision or termination of the Renewed Price Cap
20 Plan by submitting an application to the Commission for review by the

1 Commission, Staff, RUCO, and any other interested parties at least 9 months
2 prior to the expiration of the Renewed Price Cap Plan. Qwest shall serve its
3 application upon all Parties to this Settlement Agreement.

4 If Qwest's application is for an extension, revision or termination that would
5 increase Arizona regulated revenues in aggregate by more than a de minimis
6 amount, then Qwest shall file a rate case under A.A.C. R-14-2-103, at least 9
7 months prior to the expiration of the Renewed Price Cap Plan. The timeframes
8 established herein for filing shall not alter Commission rules (A.A.C. R14-2-103)
9 with respect to processing times. The procedural rules and timeframes
10 established under A.A.C. R14-2-103 §§ 7 through 11 thereof shall apply."

11 The current Price Cap Plan includes no requirement to file a rate case. The Revised
12 Price Cap Plan does in cases where Qwest's application for an extension, revision
13 or termination would increase Arizona regulated revenues in aggregate by more
14 than a de minimis amount above the increased revenues that the parties agreed
15 upon as part of this Agreement and that are permitted by the Renewed Price Cap
16 Plan.

17 **Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?**

18 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

**IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION
PLAN**

)
) **DOCKET NO. T-01051B-03-0454**
)

**IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS**

)
) **DOCKET NO. T-00000D-00-0672**
)
)
)

PHILIP E. GRATE

EXHIBITS OF

DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT

ON BEHALF OF

QWEST CORPORATION

SEPTEMBER 6, 2005

INDEX OF EXHIBITS

DESCRIPTION	EXHIBIT
Schedule showing the elements of revenue requirement representing the difference between Qwest's position in testimony and the Agreement.	PEG-S01
<u>Confidential</u> copy of Qwest's year-to-date December 1990s report for Arizona for the years 2001, 2002, 2003 and 2004 modified to reflect ratemaking adjustments for accounting for OPEBs and internal-use software as stipulated in the Agreement and further modified to include ratemaking adjustments for a \$72 million directory revenue imputation and for state and local taxes.	PEG-S02

Calculation of the elements of revenue requirement representing the difference between Qwest's position in testimony and the Settlement Agreement.

1) Detail of Differences:
(\$ 000's)

Ln	Adjustment #	Adjustment Description	Qwest Revised Revenue Requirement Per Settlement	A	Qwest (1) Revenue Requirement Per Testimony	B	Difference Between Qwest Position in Testimony vs the Settlement Agreement	C=A-B	Running Total RevReq	D=D1 + Sum C
1	Total	Total Revenue Requirement (Rejoinder Testimony of Philip E. Grate pg 21)								355,449
2										
3	Per Books	Per Books Revenue Requirement at Qwest 11.18% ROR	417,448	417,448	417,448				355,449	
4	All	Effect of Stipulated ROR of 9.50% on Original Cost Rate Base	(49,757)	(49,757)				(49,757)	305,692	
5	PFA-02	PFA-02 Post Employment Benefits Other Than Pensions	23,397	23,397	43,239			(19,842)	285,849	
6	PFA-03	PFA-03 REVISED SOP98 Adoption	(13,010)	(13,010)	17,608			(30,618)	255,231	
7	PFA-01 & PFN-11	PFA-01 Depreciation and PFN-11 Depreciation Synchronization	(262,780)	(262,780)	(143,180)			(119,600)	135,632	
8										
9	All Other	Net of all issues not stipulated in Settlement Agreement	(83,497)	(83,497)	20,335			(103,832)	31,800	
10	Sum Lns 3 thru 9	Revenue Requirement Proposal	31,800	31,800	355,449			(323,649)	31,800	

(1) Qwest Revenue Requirements for PFA-01, PFA-02, PFA-03 and PFN-11 are sourced from Exhibit PEG-RJ05 in Rejoinder Testimony of Philip E. Grate, but revised to reflect Staff factors for ROR and Revenue Multiplier. This avoids a double count of differences due to Staff factors already included in Ln 6

2) Summary of Differences (Summary of Column C in Table 1):
(\$ Millions)

Stipulated Jurisdictional Accounting Issues	Difference Between Qwest Position in Testimony vs the Settlement Agreement
Stipulated Rate of Return on Original Cost Rate Base	(170.0)
Unstipulated Rate-making Issues	(49.8)
Total Revenue Deficiency Difference	(103.8)
	(323.6)

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1201
VERSION 504

ACCOUNT DESCRIPTION	MR YTD BOOKED OPERATIONS 1A1	JD YTD OFFBOOK OPERATIONS 1B1	JR YTD BOOKED OPERATIONS 1C-A-21	YTD DEREG 1D1	YTD BILLING & COLLECTION 1E1	MR YTD INTERSTATE OPERATIONS 1F1	MR YTD INTRASTATE OPERATIONS 1G-A-D-21	JR YTD INTRASTATE OPERATIONS 1G-F-21
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REVENUES

- 1 LOCAL SERVICE
- 2 ACCESS SERVICE
- 3 LONG DISTANCE SERVICE
- 4 MISCELLANEOUS
- 5 TOTAL REVENUE

EXPENSES

COSTS OF SERVICES AND PRODUCTS

- 6 MAINTENANCE
- 7 ENGINEERING
- 8 NETWORK OPERATIONS
- 9 NETWORK ADMINISTRATION
- 10 ACCESS

OTHER

- 11 TOTAL COST OF SERV AND PRODS
- 12 SELLING, GENERAL & ADMINISTRATIVE
- 13 CUSTOMER OPERATIONS
- 14 CORPORATE OPERATIONS
- 15 PROPERTY AND OTH OPERAT TAXES
- 16 UNCOLLECTIBLES
- 17 TOTAL SELL, GEN AND ADMINIST
- 18 OTHER OPR INCOME & EXPENSE
- 19 DEPRECIATION AND AMORTIZATION
- 20 UNIVERSAL SERVICE FUND
- 21 LINK UP AMERICA
- 22 TOTAL OPERATING EXPENSES
(L12+L17+L18+L19+L20+L21)
- 23 INCOME FROM OPRS BEFORE TAXES
(L5-L22)

INCOME TAXES

- 24 FEDERAL
- 25 STATE AND LOCAL

- 26 NET OPERATING INCOME
(L23-L24-L25)

- 27 INTEREST EXPENSE
- 28 NONOPER INC & EXP

- 29 NONOPERATING INCOME TAX

- 30 JURIS DIFF & NONREG NET INCOME
- 31 EXTRAORDINARY ITEMS
- 32 NET INCOME
(L26-L27-L28-L29-L30-L31)

- 33 NET INCOME AVAILABLE FOR TOTAL
CAPITAL OBLIGATIONS

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Testimony of Phillip E. Grate
September 6, 2005
Confidential Exhibit PEG-S02

QWEST
SEPARATED RESULTS OF OPERATIONS

STATE: Arizona

VIEW: FINL201

VERSION 504

ACCOUNT DESCRIPTION

RETURNS

- 34 RETURN TO EQUITY
- 35 RETURN ON AVG TOTAL CAPITAL
- 36 RETURN ON AVG NET INVESTMENT

CAPITAL

- 37 AVERAGE EQUITY
- 38 AVERAGE DEBT
- 39 AVERAGE TOTAL CAPITAL
- 40 AVERAGE UNAMORTIZED JDIC
- 41 AVERAGE TOTAL CAPITAL INC JDIC

AVERAGE INVESTMENT

- 42 PLANT IN SVC
- 43 PLT UND CONST SHORT
- 44 PLT UND CONST LONG
- 45 PLANT UNDER CONSTRUCTION
- 46 PROP HELD FOR FUT USE
- 47 PLT ADJ
- 48 MATERIALS & SUPPLIES
- 49 ACCUM DEP
- 50 ACCUM AMORT
- 51 ACCUMULATED DEP & AMORT
- 52 ACCUM DEFERRED TAX RESERVE

- 53 AVERAGE NET INVESTMENT
(L42-L45-L46-L47-L48-L51-L52)

OTHER INVESTMENT DETAIL

- 54 CUSTOMER DEPOSITS
- 55 AVG LAND LEVEL ACREE DEPOSITS
- 56 AVG OTHER SPEC CONSTR DEPOSITS

MR YTD
BOOKED
OPERATIONS
LAL

JD YTD
OFFBOOK
OPERATIONS
JBL

JR YTD
BOOKED
OPERATIONS
JC-A+BL

YTD
DEREG
IDL

YTD
PART X

YTD
BILLING
& COLLECTION
JEL

MR YTD
INTERSTATE
OPERATIONS
JEL

NR YTD
INTRASTATE
OPERATIONS
JE-A-D-EI

JR YTD
INTRASTATE
OPERATIONS
JG-F-EI

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FIN1201
VERSION 504

ACCOUNT DESCRIPTION	JR YTD PERCENT	INTRASTATE INSG/CI	Ratemaking Adjustment Reverse	Ratemaking Adjustment Remove	Ratemaking Adjustment Pre-2001 SOP 98-1	Directory Imputation	Ratemaking Adjustment OPER	Ratemaking Adjustment (blank)	Adjusted JR YTD Intrastate Operations
			ILL	ILL	ILL	IKL	ILL	IML	IN-G-I-J-K-L

REVENUES

- 1 LOCAL SERVICE
- 2 ACCESS SERVICE
- 3 LONG DISTANCE SERVICE
- 4 MISCELLANEOUS
- 5 TOTAL REVENUE
- EXPENSES
- COSTS OF SERVICES AND PRODUCTS
- 6 MAINTENANCE
- 7 ENGINEERING
- 8 NETWORK OPERATIONS
- 9 NETWORK ADMINISTRATION
- 10 ACCESS
- 11 OTHER
- 12 TOTAL COST OF SERV AND PRODS
- SELLING, GENERAL & ADMINISTRATIVE
- 13 CUSTOMER OPERATIONS
- 14 CORPORATE OPERATIONS
- 15 PROPERTY AND OTH OPERAT TAXES
- 16 UNCOLLECTIBLES
- 17 TOTAL SELL, GEN AND ADMINIST
- 18 OTHER OPS INCOME & EXPENSE
- 19 DEPRECIATION AND AMORTIZATION
- 20 UNIVERSAL SERVICE FUND
- 21 LINK UP AMERICA
- 22 TOTAL OPERATING EXPENSES
- (L12-L17-L18-L19-L20-L21)
- 23 INCOME FROM OPS BEFORE TAXES
- (L5-L22)

INCOME TAXES

- 24 FEDERAL
- 25 STATE AND LOCAL
- 26 NET OPERATING INCOME
- (L23-L24-L25)
- 27 INTEREST EXPENSE
- 28 NONOPER INC & EXP
- 29 NONOPERATING INCOME TAX
- 30 JURIS DIFF & NONREC NET INCOME
- 31 EXTRAORDINARY ITEMS
- 32 NET INCOME
- (L26-L27-L28-L29-L30-L31)

- 33 NET INCOME AVAILABLE FOR TOTAL
CAPITAL OBLIGATIONS

REDACTED

CONFIDENTIAL
1990 REPORT PROCESSOR
For Year 2001

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL:201
VERSION 504

ACCOUNT DESCRIPTION

RETURNS

34 RETURN TO EQUITY
35 RETURN ON AVG TOTAL CAPITAL
36 RETURN ON AVG NET INVESTMENT

CAPITAL

37 AVERAGE EQUITY
38 AVERAGE DEBT
39 AVERAGE TOTAL CAPITAL
40 AVERAGE UNAMORTIZED JDIC
41 AVERAGE TOTAL CAPITAL INC JDIC

AVERAGE INVESTMENT

42 PLANT IN SVC
43 PLT UND CONST SHORT
44 PLT UND CONST LONG
45 PLANT UNDER CONSTRUCTION
46 PROP HELD FOR FUT USE
47 PLT ADJ
48 MATERIALS & SUPPLIES
49 ACCUM DEP
50 ACCUM AMORT
51 ACCUMULATED DEP & AMORT
52 ACCUM DEFERRED TAX RESERVE

53 AVERAGE NET INVESTMENT
(L42-L45-L46-L47-L48-L51-L52)

OTHER INVESTMENT DETAIL

54 CUSTOMER DEPOSITS
55 AVG LAND DEVEL AGREE DEPOSITS
56 AVG OTHER SPC CONSTR DEPOSITS

JR YTD PERCENT INTRASTATE JH=G/CL	Rate-making Adjustment: Reverse Offbook SOP 98-1 JLI	Rate-making Adjustment: Remove Pre-2001 SOP 98-1 JLI	Rate-making Adjustment: Directory Imputation JKL	Rate-making Adjustment: Blank JML	Adjusted JR YTD Intrastate Operations JNL=G-I-J-K-L-J
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REDACTED

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF WASHINGTON
COUNTY OF KING

AFFIDAVIT OF
PHILIP E. GRATE

SS

Philip E. Grate, of lawful age being first duly sworn, deposes and states:

1. My name is Philip E. Grate. I am State Finance Director for Qwest Corporation in Seattle, Washington. I have caused to be filed written testimony in support of the settlement agreement in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Philip E. Grate
Philip E. Grate

SUBSCRIBED AND SWORN to before me this 30th day of August, 2005.



Lori L. White
Notary Public

My Commission Expires:

7/10/07